FAMILY WEALTH REPORT

Unified Managed Accounts And Overlay: Gaining Traction In Wealth Management

Harriet Davies, Editor

Unified managed accounts are set to become the wealth management industry norm, Jerry Michael, president and co-founder of Smartleaf, tells Family Wealth Report. He says the Cambridge, MA-based firm, which provides overlay portfolio management technology, is seeing considerable growth as the UMA model gains traction. He believes in the long run it could challenge not only separately managed accounts but mutual funds.

Overlay technology is an approach whereby every account replicates a blend of one or more "model" portfolios, separating research ideas (expressed as these model portfolios) and customized factors (tax, social constraints, etc).

The new normal

Previously, the big motivation to adopt the technology was as a better way to deliver open architecture, "but instead of sending the money out you bring the ideas in," says Michael. Using the software there are no sub-advisors, only the overlay manager.

However, Michael now thinks the movement has its own momentum, beyond as a way of implementing open architecture, and the UMA/overlay option is becoming the common platform for wealth management. As an example, the company recently implemented the technology across all US Bancorp's wealth management operations – a company with some $308 billion in assets, and the parent of the fifth largest commercial bank in the US. Other institutions have made the same decision, Michael says.

When asked what is driving such moves, he thinks it is partly because the technology has reached the maturity level where it is proven, and also that banks are realizing this is not just a detail of the back office, but a point on which they can build competitive strategies.

The crisis of 2008 has also played its part in speeding up technological churn. Firstly, Michael says, this acted as a catalyst for businesses to take stock and think: what does it mean to be a wealth manager? “And they realized it’s not just about stock picking, but about listening to clients’ needs and delivering a fully customized solution,” he says.

“This is a common theme we hear from our clients, that it’s about really servicing their clients’ needs,” says Robert Sandrew, Smartleaf’s director of business development.

Certainly there has been a heightened focus on listening to and engaging with clients since the financial crisis. This was partly prompted by poor performance in many areas of the industry, leading clients to question what value they were getting from their service. Also, as wealth holdings were cut in many instances, a renewed focus on costs came about. Essentially, wealth managers found themselves having to deliver more for less.

And this is what overlay technology is all about, according to Michael. Unified managed accounts using third-party models are less expensive than mutual funds (with average costs at around 50-60 basis points compared to 120 basis points), he says, and allow scalable implementation of best-in-class ideas.

“One particular advantage of deploying overlay as a common platform is that it supports all combinations of proprietary/third-party models and all combinations of equities, mutual funds, ETFs, ADRs, individual fixed income, etc, in a single account,” says Michael. He adds that this radically simplifies operations, and reduces costs.

However, the trend the firm has observed so far has tended to be wealth managers delivering more – in terms of enhanced tax management, and more client time – rather than cutting fees. But in theory this could work either way.

Perhaps unsurprisingly, Michael expects the UMA approach to impact not only separately managed accounts but the mutual funds sector in the long run. This would be as clients move towards holding individual equities as opposed to equity funds, while using mutual funds to hold illiquid asset classes, or for smaller client accounts.

But he backs up his optimism with convincing figures: assets managed through Smartleaf’s overlay technology have grown from $10 billion in 2008 to $35 billion at the end of Q3 2010 – the latest date for which the figures are available.

Speed, compliance

Another effect of the crisis was that tax and compliance issues came under intense scrutiny. The political climate changed, as scandals rocked the financial world, and revealed the scope for error in the system.

“In the past, firms had compliance reviews on a quarterly or even annual basis. Overlay implements this on a daily basis,” says Michael. And the same goes for asset allocation: you can implement a decision in one business day in a fully tax-compliant manner. “Many firms may have had the right idea [on asset allocation], but they couldn’t implement it fast enough,” he adds.

Others in the industry are starting to realize the growing importance of the UMA and overlay option, he says. As yet though the firm only has domestic firms on its platform. This could be because the US has moved further towards using the UMA model of wealth management, as anecdotal evidence suggests.

But Michael says the idea is perfectly replicable, and there are no limitations to Smartleaf doing business in Canada or Europe, for instance. And this may not be far off the cards, as according to Sandrew some large Canadian firms have started to take notice of the technology in recent months.

“It’s not just about open architecture; it’s the way wealth management is going. It’s much easier, and much less expensive,” says Michael.

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